Better Buying Power Initiative
Incentivize Productivity
&
Innovation in Industry

Brief to Defense Acquisition University Symposium

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Agenda

- What the Team was chartered to review
- Direction was given to the Components
- Updates on initiative implementation

BBPI
Incentivize Productivity & Innovation in Industry

THE TEAM CHARTER June 28 2010 AT&L Memorandum

Providing Incentives for Greater Efficiency in Industry

- **LEVERAGING REAL COMPETITION:** Avoid directed buys and other substitutes for real competition. Use technical data packages and open systems architectures to support a continuous competitive environment.
- **USING PROPER CONTRACT TYPE FOR DEVELOPMENT AND PROCUREMENT:** Phase out award-fee contracts and favor fixed-price or cost-type incentive contracts in which government and industry share equally in overruns and underruns, and overruns have analytically-based caps. Use cost-reimbursement contracts only when either government requirements or industry processes cannot be adequately specified to support pricing. Adjust sole-source fixed-price contracts over time to reflect realized costs. Work down undefinitized contract actions. Seek authority for multi-year contracts where significant savings are possible.
- **USING PROPER CONTRACT TYPE FOR SERVICES:** Phase out Time and Material and sole-source ID/IQ contracts wherever possible. Utilize fixed-price performance-based contracts when requirements are firm and can be measured, with payments tied to performance. Utilize fixed-price level of effort or cost-plus-fixed-fee contracts (with profit/fee tied to weighted guidelines) when requirements are still being defined. Award fees should be used only by exception. Maximize the use of multiple-source, continuously competitive contracts.
- **ALIGNING POLICY ON PROFIT AND FEE TO CIRCUMSTANCE:** Align opportunity to earn profits/fees to both value to the taxpayer and risk to the contractor. Apply weighted guidelines to profit/fee levels. Reward higher productivity with higher profits. Incentivize investment in innovation.
- **SHARING THE BENEFITS OF CASH FLOW:** Ensure that taxpayers receive adequate consideration (price reductions) for improved cash flows. Progress payments must reflect performance but can be increased above customary levels in return for consideration by the contractor. Reduce over time the gap between proposed and actual rates in forward price rate agreements.
- **TARGETING NON-VALUE-ADDED COSTS:** Identify and eliminate non-value-added overhead and G&A charged to contracts. Limit fees for subcontractor management to reflect actual value provided (risk assumed by prime and continuous subcontractor risk reduction). Limit B&P allowable costs in sole source contracts and encourage effective use of IRAD.
- **INVOLVING DYNAMIC SMALL BUSINESS IN DEFENSE:** When establishing multiple award contracts for services, make every effort to provide for small business participation. If at least two small businesses are deemed capable of performing on such a contract, consider setting aside that work for competition among them.
- **REWARDING EXCELLENT SUPPLIERS:** Emulate the Navy's pilot program to provide special benefits to consistently excellent industrial performers.
- **PROTECTING THE TECHNOLOGY BASE: Protect the future by sustaining investment while focusing on high value added** work.

Aligning policy on profit and fee to circumstance

- What this was NOT

  Not a discussion about reducing profit

- What it WAS
  - An examination on how to reduce cost
  - An examination to allow prime contractors to make profit for appropriate value added
  - An examination of how to influence management of subcontractors

What was learned

The Department pays profit/fee to prime contractors

- on work they conduct themselves,
- work subcontracted by the prime contractor to subcontractors,
- and allowable overhead and administrative costs.

All three are appropriate. However

- level of profit should be calculated to reward performance.
- Profit on subcontracted work should compensate for burden of managing subcontractor risk and delivering subcontractor value.

Higher profit should be

- awarded to management of higher-risk subcontracts
- given when the prime succeeds in driving down subcontractor costs every year
- an incentive to control overhead cost.

There was evidence, however, that blanket profit levels are set and, what is more, are not revisited periodically in light of actual performance.

ACTION -Reward contractors for successful supply chain and indirect expense management

Required DoD to address its manner of business:

- Instructed Director of Defense Procurement and Acquisition Policy (DPAP) to
  - review the Weighted Guidelines for profit
  - emphasize the tie between profit and performance.

- Directed managers of ACAT ID programs to provide,
  - reward and incentive strategy behind their profit policy
  - include consideration of breakout alternatives where appropriate.
  - directed the CAEs to do the same in programs for which they have acquisition authority.

It is important to note that the savings to be expected from this direction will be in cost, not in profit. Savings are not expected in profit per se since in some *instances profit will increase to reward risk management and performance. But if profit policy incentivizes reduction in program*

Using Proper Contract Type For Development and Procurement

- What it WAS
  - An examination on how we choose contract types
  - An examination of how well the acquisition workforce was trained
  - An examination of how to influence behavior through contract type

What was learned

Choosing contract type

- one important way of aligning incentives of the government and the contractor.
- One size does not fit all.
- Department once attempted to impose fixed-price contracts on efforts where significant invention (and thus unknowable costs) could be anticipated.
- More recently, Cost Plus Award Fee (CPAF) contracts with subjective measures of award fee not clearly tied to cost control became widespread.

ACTION -Increase the use of Fixed-Price Incentive Firm Target (FPIF) contract type where appropriate using a 50/50 share line and 120 percent ceiling as a point of departure

Direction to CAEs:

- Effective immediately
  - give greater consideration to using (FPIF) contracts, particularly when moving from development to production.
  - provide justification for contract type used for each proposed contract above $100 million for ACAT ID programs.
  - review contract type chosen for all contracts for more than $100 million under other ACAT levels.
  - acquisition teams must pay particular attention to share lines and ceiling prices,
  - FPIF contracts with a 120 percent ceiling and a 50/50 share ratio should be the norm, or starting point.
  - a higher proposed ceiling requires explanation to the relevant head of contracting authority.

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Sharing the Benefits of Cash Flow

- What it WAS
  - An examination of the time value of money
  - An examination of internal tools to help acquisition workforce determine cash flow impact
  - An examination of influencing factor of progress payments

What was learned

Choosing contract type

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What was learned

The government is an exceptionally reliable customer in terms of financing

- Department pays up front and regularly,
- sometimes before products are delivered.
- Department finances most industry investment needed to prepare products for the defense market.
- Department can therefore offer a high cash flow return on invested capital, a feature highly valued by investors.
- Financial environment offers another opportunity to reward good performance.
- Department should use innovative contract financing methods to incentivize vendors with the time value of money in exchange for

ACTION - Adjust progress payments to incentivize performance.

Direction to CAEs:

- Effective immediately
  - identify pilot programs to use innovative financing methods as a negotiating tool.
  - directed DPAP to immediately develop a cash flow model
  - provide guidance for the use of a preferred hierarchy of innovative financing methods described in the model that takes into consideration the lifecycle phase of weapon system programs.
  - emphasis placed on flow-down provisions to subcontractors as well.

As a matter of practice, on all fixed price type contracts, I expect that the basis of negotiations shall be the use of customary progress payments. After agreement on price on the basis of customary progress payments, the contractor shall have flexibility to propose an alternate payment arrangement for the Government's consideration.

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Rewarding Excellent Suppliers

- What it was NOT
  - A method of providing preference for contract award
  - A reduction of suppliers

- What it WAS
  - An examination of how well government data sources support decisions
  - An examination of how to reward excellence
  - An examination of how identification of excellence can improve greater industry performance

What was learned

The Department should recognize and reward businesses and corporations that consistently demonstrate exemplary performance.

- Department has experience with these types of programs in certain parts of our business..
- Department must ensure it is only for favorable post-award special terms and conditions .
- Department should expand the Navy announced pilot to a DoD wide program

ACTION - Extend the Superior Supplier Incentive Program (SSIP) to a DoD-wide pilot

Direction:

- Navy to continue to lead the pilot but immediately include the other Services and DoD components in order to transition to a full DoD program as soon as practical.

- Consider
  - more favorable progress payments
  - higher designated ranges in the weighted guidelines
  - special award fee pools
  - other potential post-award advantages to appropriately reward those corporate/business suppliers that the Department can count on to repeatedly deliver the value that we expect

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Protecting the Technology Base

- What it WAS
  - An examination of how the Department invests in Independent Research and Development (IRAD)
  - An examination of how the Department takes advantage of technology investments it has paid for and can use for future competition
  - An examination of how Small Business Innovative Research (SBIR) technologies can be enhanced

What was learned

The Department reimburses industry as an allowable cost over $3 billion annually in “Independent Research and Development” (IRAD)..

- one of our principal investments in technology innovation
- larger than any single military department’s annual Science and Technology (6.1-6.3) program.
- no insight into how or where these funds go or
  - if they benefit the Department or
  - if they promote the technological prowess of our industry
- result has been loss of visibility into the linkage between funding and technological purpose

ACTION - Extend the Superior Supplier Incentive Program (SSIP) to a DoD-wide pilot

Direction:

- align the purpose of IRAD to actual practice
  - Director of Defense Research and Engineering (DDR&E) should engage with the largest of the performers of IRAD to collect data on how they have used these funds in recent years
  - Request Defense Contract Audit Agency (DCAA) to collect and provide IRAD financial data from all firms with allowable IRAD costs.
  - DDR&E to provide a plan for a pilot program, to improve the return on IRAD investments for industry and government.

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SUMMARY

AT&L has transitioned to all OSD leadership

- Reward contractors for successful supply chain and indirect expense management - DPAP
- Increase the use of Fixed-Price Incentive Firm Target (FPIF) contract type where appropriate using a 50/50 share line and 120 percent ceiling as a point of departure -DPAP
- Adjust progress payments to incentivize performance - DPAP
- Extend the Superior Supplier Incentive Program (SSIP) to a DoD-wide pilot - DPAP
- Reinvigorate industry's independent research and development and protect the defense technology base – DDR&E